FEP WORKING PAPERS
Research Work in Progress
n. 282, July 2008

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HOW IS THE RELATIONSHIP SIGNIFICANCE BROUGHT ABOUT? A CRITICAL REALIST APPROACH*

Abstract

The markets-as-networks theorists contend, at least tacitly, the significance of business relationships for the focal firm – that is, business relationships contribute somewhat to the focal firm's survival and growth. We do not deny the existence of significant business relationships but sustain, in contrast to the consensus within the Markets-as-Networks Theory, that relationship significance should not be a self-evident assumption. Significance cannot be a taken-for-granted property of each and every one of the focal firm's business relationships.

We adopt explicitly a critical realist position in this conceptual paper and claim that the relationship significance is an event of the business world, whose causes remain yet largely unidentified. Where the powers and liabilities of business relationships (i.e., their functions and dysfunctions) are put to work, inevitably under certain contingencies (namely the surrounding networks and markets), effects result for the focal firm (often benefits in excess of sacrifices, i.e., relationship value) and as a result the relationship significance is likely to be brought about. In addition, the relationship significance can result from the dual influence that business relationships have on a great part of the structure and powers and liabilities of the focal firm, i.e., its nature and scope respectively.

Keywords: Markets-as-Networks Theory, relationship significance, business relationships, focal firm, resources, competences, activities

* The authors appreciate the in-depth remarks of an anonymous reviewer of the 24th IMP Conference (see http://imp2008.impgroup.org) to an earlier draft of this paper. All errors and omissions remain their own.

1. INTRODUCTION

The Markets-as-Networks Theory aims to describe and explain the vertical interactions and relationships established and maintained between firms, namely buyers and sellers. It is the notorious offspring of the analytical and empirical work conducted almost over the last four decades by the Industrial Marketing and Purchasing (IMP) Group, a worldwide research community dedicated to the study of business relationships and networks (Easton and Hakansson 1996; Hakansson and Snehota 2000; McLoughlin and Horan 2000a, 2002, 2000b; Turnbull et al. 1996; Wilkinson 2001). Though clearly not monolithic (i.e., meaning different things to different people), the theory features at least three major conceptual cornerstones: (i) *the existence of business relationships* (Axelsson and Easton 1992; Blois 1972; Easton and Araujo 1986; Ford 1980, 1978; Hakansson et al. 1979; Monthoux 1975; Turnbull and Cunningham 1981; Turnbull and Paliwoda 1986; Turnbull and Valla 1986), *as well as their connectedness* (Anderson et al. 1994b; Ritter 2000) *and uniqueness* (Hakansson and Snehota 1995); (ii) *business relationships as a third type of governance structure, alternative to both hierarchies and markets* (Richardson 1972); and (iii) *the significance of business relationships for the focal firm*, henceforth the '*relationship significance*'[1] (Cunningham 1980; Gadde et al. 2003; Johanson and Mattsson 1987). This conceptual paper is exclusively concerned with the last of these cornerstones, in particular with the identification of the *causes* eventually bringing about such relationship significance. But let us first explain what the relationship significance is all about.

The notion of 'relationship significance' is meant here to denote '*the influence of business relationships on the focal firm's survival or growth*'. That we are sticking to the meaning as often assumed by the markets-as-networks theorists, and not advancing a putative one, is supported by Hakansson and Snehota's (1995, p. 267, emphasis added) words: "In order to survive and develop you *have to have* counterparts (…).". Ford and Hakansson (2006a, p. 22, emphasis added) convey the same: "Companies can choose if and how they want to do something particular relative to a specific counterpart. But they *cannot choose whether or not*

[1] The significance of a business relationship exists of course in *relation to* a particular entity, e.g., the focal firm, its supplier A or customer B. One needs to oppose to the more or less dominant view across the markets-as-networks theorists that relationship significance is considered *in and of itself*, that is to say, business relationships are significant *per se* and not *for* a specific entity. It seems however senseless to think of the relationship significance in abstract. For whenever the significance of something or of someone is presumed, a question immediately arises: '*significant for whom?*'. That we consider here the significance of business relationships for the focal firm, i.e., adopt the focal firm's viewpoint, seems appropriate at least if it is acknowledged that "[r]elationships are (…) an important structural dimension [of the business network] as fundamental as organisations themselves" (Ford and Hakansson 2006b, p. 252). This viewpoint should not be equated with the '*firm-centred view of the world*' or the '*single-firm perspective*' so commonly found in Management theory, whereby the focal firm is presumed to be an atomistic entity solely concerned with its own objectives and interests and having complete discretion in behaviour. Though the Markets-as-Networks Theory usually endorses the perspective of the '*focal business relationship*' or the '*focal business network*' (Easton and Hakansson 1996), the focal firm's viewpoint needs not be at odds with a '*relative world*' within which interfirm interaction predominates.

to have relations with others, including their suppliers and customers.”. Blois (1998, p. 256, emphasis added) goes even further, by stating that “(…) it is *impossible* for firms *not to have* [vertical] relationships (…)”. The existence of the focal firm cannot be conceived of without business relationships, in contrast to what most orthodox economists postulate (e.g., Henderson 1932, p. 85). No existing (i.e., surviving) firm is ‘*an island in a sea of arm’s-length (market) relations*’ (Hakansson and Snehota 1989; Richardson 1972). All the business relationships that the focal firm establishes, develops, maintains, and terminates with counterparts (most notably suppliers and customers) affect somewhat its functioning and development (Ford and McDowell 1999). The focal firm, in the event of deliberately terminating its established business relationships (or seeing those abruptly ended by the counterparts’ will), is not only somehow impeded to operate and grow, but more importantly, it is likely to perish. As Ford et al. (1998, p. 13) put it: “A company’s relationships are important assets and without them it could not operate, or even exist.”. Business relationships are therefore *significant* for the focal firm. Needless to say, the relationship significance also exists in relation to the counterparts with which the focal firm is connected. Suppliers and customers are as dependent on business relationships (for survival and growth) as the focal firm is.

Given that the relationship significance is a primordial cornerstone of the Markets-as-Networks Theory, it seems paradoxical that its causes are for the most part left unidentified. It is quite common to find within any theory some issues which are seen as unchallengeable and others, less obvious, which remain greatly unexplored. The relationship significance is bound to be one of the ‘*currently hidden aspects of business networks*’ (Alajoutsijarvi et al. 2001, p. 104). Although the Markets-as-Networks Theory provides a ‘*general picture of the significance of business relationships*’ (Ford and Hakansson 2006b, p. 251), we claim that relationship significance is largely an understudied and taken-for-granted issue whose potential causes are not yet subject to a systematic and thorough analysis by the markets-as-networks theorists. To our best knowledge, Wiley et al.’s (2006; 2003) empirical research on the ‘*sources*’ of relationship significance (as *perceived* only *by suppliers*) in Sweden, Germany, and China is a meritorious exception.

Many markets-as-networks theorists assert and reiterate the relationship significance (see, e.g., Ford and Hakansson 2006b) but seldom if ever discuss it in depth. Such a discussion is allegedly unneeded because all research conducted by the IMP is ‘*about the various ways in which business relationships are significant*‘. Or, even more emphatically, “[t]he IMP research *confirmed* the *significance* of lasting customer-supplier relationships" (Blankenburg-Holm and Johanson 1992, p. 6, emphasis added). Such foundationalist position, for sure dispensable, is easy to explain. The markets-as-networks theorists take business relationships to be almost *by definition* significant for the focal firm. Their reasoning is basically the following: *if* business relationships are *de facto* deliberately initiated, nurtured, and sustained by the focal firm, *then* business relationships must have some usefulness (i.e., be somewhat significant) for that purposive entity. The markets-as-networks theorists observed and reported recurrently the focal firm as willingly related to and heavily dependent on several counterparts, inferring therefore that such business relationships *ought to be* significant to some extent for the focal firm. In sum, theorists have taken the pervasive existence of business relationships as a secure warrant of their significance. The taken-for-grantedness of relationship significance is, of course, attested by the absence of explicit debate within the Markets-as-Networks Theory. Yet it is made clear by Hakansson and Snehota (1995, p. 330) who contend that the foci of interest of the markets-as-networks theorists are '*the important [vertical] relationships*' to the disfavour of '*uninteresting and unimportant]*' ones, as if (i) business relationships are *a priori* significant for the focal firm while (ii) the purely transactional relations are as a rule insignificant for the focal firm.

We do not deny the existence of significant business relationships but argue, contra the consensus within the Markets-as-Networks Theory, that relationship significance should not be considered an axiom. Significance is surely not a property of each and every one of the focal firm's business relationships. The relationship significance is real but does not exist always and at all times – that is, business relationships need not be necessarily significant to some extent for the focal firm. Business relationships are not necessarily '*islands of significance in a sea of ordinariness*' (cf. Ford and Hakansson 2006a, p. 11): their significance is liable to change over time and they can be even on occasion *burdens* or *liabilities* for the focal firm (Hakansson and Snehota 1998). That the focal firm is likely to have but a few (highly?) significant business relationships is corroborated by the recurrent observation made by the markets-as-networks theorists that a limited number of suppliers and customers account for the majority of firms' total purchases and sales respectively (the '*80/20 rule*').

We adopt explicitly a *critical realist* perspective and claim that the relationship significance is a notorious *event* of the business world, taking place intermittently and '*here and there*' – an event that co-exists with others (e.g., the arm's-length or purely transactional relations between firms) and is not always rightly perceived as such by the focal firm (Wiley et al. 2006). Of course, that event's occurrence does not depend on the existence of such a perception, correct or not. Each business relationship is what it is (either highly significant, totally insignificant, or somewhere in between) regardless of any perceptions held in that regard by the focal firm or any other firm.[2] Though the relationship significance is unlikely to be objectively identified by firms or their members, it is 'something' which can or cannot result, on account of certain yet ungrasped causes. Therefore the main objective of this paper is to identify, in a tentative manner, the *causes* (i.e., *structures* and *powers*) potentially responsible for bringing about such event.

The paper is organised as follows. First, the Critical Realism that serves as our meta-theoretical point of departure here is presented. Then, we offer a brief outlook of the business world, and its several entities and events. In particular, the underlying causes of the relationship significance are advanced. Lastly, we present our concluding remarks, namely the main theoretical implications and limitations of the paper as well as a future research agenda.

2. THE META-THEORETICAL POINT OF DEPARTURE

Scholars and researchers build necessarily upon a particular set of assumptions in their investigations of the world – what is commonly entitled their guiding *Philosophy of Science* or *Meta-theory*. Such assumptions, which every scholar and researcher should be aware of and make unambiguous if not explicit, concern: (i) *the way the world is* (i.e., *ontology*); (ii) *how the world can be known* (i.e., *epistemology*); (iii) *which methods and techniques can be employed in its inquiry* (i.e., *methodology*); and (iv) *what causes the world to be as it is* (i.e., *aetiology*). Ontology is often claimed to be the overriding meta-theoretical dimension for it is very likely to influence epistemology, methodology, and aetiology. The questions formulated, as well as the answers tentatively offered, are likely to differ on account of different meta-

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[2] The focal firm holds a particular position in the network (e.g., central or peripheral), a position that results from a lengthy, costly, cumulative, and interdependent investment process (Mattsson 1989) and sets limits on its behaviour and enforces its rights and obligations in the network, both in the present and future (Henders 1992). Owing to that position, the focal firm is likely to have but a limited knowledge of the surrounding network in which it is deeply embedded, thus needing to make sense of that network via the *network pictures* it builds and revises over time (Ford and Redwood 2005; Henneberg et al. 2006). The focal firm is necessarily myopic, with its network horizon is more or less narrow. The focal firm's more or less 'realistic' pictorial representations of what is within and beyond its *network horizon* – the part of the network that it is aware of and thereby can take into account (Holmen and Pedersen 2003) – contribute to: (i) the continuous upgrading of its *network theory*, i.e., perceptions, expectations, intentions, beliefs, mental models, cognitive maps, schemas, and ideologies guiding at large its behaviour in the network (Mattsson and Johanson 1992; Welch and Wilkinson 2002); and (ii) the reinforcement or change of its *network identity*, i.e., the views inside and outside the focal firm about its role and attractiveness for others in the network (Hakansson and Johanson 1988). Ford and Hakansson (2006a) include the '*subjective interpretation*' of individuals and groups within the focal firm in their enumeration of the core features of interfirm interaction. Even though the focal firm's perception does not *per se* make a business relationship significant or contrariwise, the possibility that such a perception may have repercussions on the significance of that relationship in the future should not be excluded altogether. For instance, the focal firm can mistakenly regard the (somewhat significant) business relationship with supplier A as completely insignificant and take deliberate steps to end it or not nurture it and possibly leading to its fading over time.

theoretical commitments. Likewise any criticisms to the work of scholars and researchers need to be made by taking their respective meta-theory into consideration. Where the meta-theoretical commitments are unclear or remain unexamined (or worse, are 'buried' within developed or espoused theories), one often finds them at cross-purposes, talking past one another instead of engaging in constructive and intelligible debates. Meta-theory can hence be defined as what lies beyond or outside any *substantive theory* (Fleetwood and Ackroyd 2004a, 2004b). The possibility of the former influencing somewhat the latter does not make the relation between the two tight (Sayer 2004): though having the 'right' meta-theory does not necessarily lead us to develop an unchallengeable theory, one is unlikely to arrive at a 'right' theory when starting from a 'wrong' meta-theory (though it can happen by pure chance). Of course, change is more pronounced and frequent in theories than in meta-theories.

Whatever the field of study, each and every scholar and researcher adopts often in an implicit way one of three meta-theories (Fleetwood 2007a, 2005): *Positivism*, *Postmodernism*, or *(Critical) Realism*. Positivists see the world as a closed system wherein determinism prevails and cause-effect relations can be empirically observed and recorded, whereas postmodernists argue that the world '*lies in the eyes of the beholder*', being fully socially constructed by mankind via discourse or interpersonal interaction and convention. For critical realists (i) the world is as a whole an open system that exists regardless of any knowledge one may have of or develop about it and (ii) the social sciences should be critical of the social world they aim to tentatively describe and explain. Moreover, Critical Realism depicts the world as composed of a myriad of *entities* and *events*, both of which need not be confined to the realm of the observable. Such entities exhibit peculiar *structures*, i.e., sets of interrelated properties which make them the kind of entities they are and not anything else. In virtue of their structures, entities necessarily possess (though may not exercise) certain *emergent powers* and *liabilities*, hence being both capable of doing some things and incapable of doing others. Events result when the powers of entities are exercised (or, on the contrary, liabilities are impeded) under specific *contingencies*, i.e., either particular geo-historical conditions or the presence or absence of other entities and the activation or obstruction of their powers and liabilities (Bhaskar 1975; Harré and Madden 1975). One example usually given to illustrate the critical realist view of the world is that of human beings. Humans, by virtue of their intricate physiological, anatomical, and social make-up (e.g., brains, respiratory systems, arms, legs, status, and so on), have the outstanding powers to think, talk, listen or run, jump, and swim – powers, of course, put to work always under the restriction of spatial and temporal conditions (e.g., a man cannot speak fluently a foreign language without proper and lengthy instruction and repeated practice nor play tennis in the absence of either a court, an opponent, a racket, or a reasonable knowledge of the game). For incisive introductions in particular to Critical Realism, see Archer et al. (1998) and Danermark et al. (1997).

The ontological, epistemological, methodological, and aetiological assumptions of these mutually exclusive meta-theories have been addressed exhaustively elsewhere (Bhaskar 1998, 1986; D'Andrade 1986; e.g., Fleetwood 2001; Fleetwood 1999, 2007a, 2007b, 2004, 2005; Lawson 2001, 1998, 1997; Patomaki 2006; Sayer 2004, 1984, 2000; Second 1986) and are summarised in Table 1 below.

Meta-teory	Ontology	Epistemology	Methodology	Aetiology
Positivism	A mind-independent world; observables; regularities (constant conjunctions of events)	Knowledge development via observation or experimentation of the world; postulation of laws (via generalisation); emphasis on prediction and objectivity	Use of quantitative methods; deduction and induction	Cause-effect relations (deterministic or stochastic); closed systems
Postmodernism	The world is built via discourse or social interaction and convention; multiple realities	The world is only known via discourse; no knowledge is better than any other (subjectivity)	Use of qualitative methods	Discourse as the (arbitrary) cause of the world
Critical Realism	At large mind-independent world; observables and unobservables; entities (with structures and powers and liabilities, emergent and potential) and events; necessity and contingency (relations); strata (real, actual, empirical)	Multiple, fallible, in part socially constructed knowledge (obtained via intervention in the world); emphasis on description and explanation; ‘tendential predictions’	Use of qualitative methods (triangulation); abstraction, ‘retroduction’, and ‘retrodiction’	The world is multiply caused, brought about by the exercise of interlocking powers, mechanisms, and configurations, under mutable contingencies; tendencies and counter-tendencies at work; open systems

Table 1 – The basic assumptions of positivist, postmodernist, and critical realist meta-theories

2.1 The suitability of a critical realist approach

The world is usually seen as divided in two: the 'natural' and the 'social', i.e., nature and society. We stand with those that believe that the world predates all human beings, for it has existed and still exists independently of men's knowledge or identification of it. While holding the *realist* conviction – that the world at large is *what it is* regardless of what humans choose to say, think, or write about it – one must also acknowledge the *social construction* of some parts of that world. Needless to say, as researchers we are mostly interested in the *social world* in general and the *business world* in particular. For surely that social world is to some degree *socially constructed* by men via their discourse or interpersonal interaction and convention (e.g., theories, rules, symbols, and so forth). Contra the arguments of those espousing a strong social constructivist or *postmodernist* stance, the social world is not merely a *tour de force* of mankind or the feasible aftermath of its intents and actions.

Since their inception in the first decades of the 20th century, the social sciences in general and Management in particular have been dominated by Positivism. Fleetwood (2007a) advances two motives accounting for the positivist orthodoxy: (i) most of the 'Research Methods' courses attended by postgraduates in universities draw (at least implicitly) upon Positivism, focusing exclusively on quantitative methods and techniques; and (ii) as the courses on 'Philosophy of Science' are extremely rare to find in universities, thus leaving absent the valuable discussion on the adequacy and shortcomings of each of the available meta-theories, many social scientists are unaware of the deficiencies of Positivism and that meta-theoretical alternatives do exist. Some social scientists however started to challenge the dominant meta-theory, especially from the 1980s onwards. Postmodernism then arose as a fierce and shocking reaction to the positivist orthodoxy that claimed the world to be objectively available and capable of being easily known by the systematic application of the empirical techniques. Its development is often denoted as the '*turn to discourse*' or the '*linguistic turn*' in Science. The distinguishing feature of a postmodernist stance is its belief that the world is not known objectively at all and what is known is merely a *tour de force* of mankind, i.e., the outcome of the variegated intents, actions, conventions, and interactions of men. Though postmodernists in general claim that only two competing meta-theories are available to inform and guide scientific research, one needs to recognise the alternative of the (Critical) Realism. Positivism and Realism, despite sharing the assumption of a mind-independent world, differ strongly with respect to the existence of observables and unobservables within the world.

While realists consider both as objects of potential inquiry, positivists fail to take the existence of unobservables into account or merely neglect them.

There have been over the years some social scientists whose work was rooted neither in positivist nor in postmodernist meta-theories. For instance, the widely known economists John Commons, Friedrich Hayek, Nicholas Kaldor, John Keynes, Carl Menger, George Shackle, Adam Smith, Joseph Schumpeter, and Thorstein Veblen, and the sociologists Karl Marx and Max Weber, all drew upon various forms of Realism (despite for the most part not using the term 'Realism'). Realism does not represent a recent meta-theoretical reaction against Postmodernism (cf. Contu and Willmott 2005; Reed 2005). There is no late '*realist turn*' in Science (Ackroyd and Fleetwood 2000a). Yet, it is undeniable that Realism only gained prominence since the mid-1970s, after its sophisticated variant known as Critical Realism being carefully articulated and refined by Bhaskar and others. Collier (1994) addresses the pivotal influence of Bhaskar on the development of Critical Realism.

The popularity of Postmodernism notwithstanding, many scholars and researchers are now increasingly prone to endorse the meta-theoretical option posed by Critical Realism. Indeed, one can find multiple examples in the social sciences of those who adopt (mostly in an implicit way) a realist perspective on their research topics. By acknowledging that the world includes things which exist independently of any knowledge of them, a large number of scientists may even be called '*minimal realists*' (Sayer 2004). For instance, the Ackroyd and Fleetwood's (2000b) and Fleetwood and Ackroyd's (2004a) edited volumes are an evidence of the growing number of realist inspired works across various sub-fields of Management, from Human Resource Management through Operations Management to Industrial Marketing and others.

We adopt explicitly a critical realist approach throughout this paper. This approach seems suitable when one bears in mind not only the foregoing meta-theoretical assumptions of Critical Realism, but also our main unit of analysis, namely the business relationships as notorious entities of the business world.

3. THE ENTITIES AND EVENTS OF THE BUSINESS WORLD

We acknowledge that the world exists for the most part independently of what one may think, say, or write about it, for the world's entities and events endure regardless of human knowledge or identification of them. Of course, we need also to recognise that the part of the world in which we are interested – the social world in general and the business world in particular – is to some extent a social construction of mankind via theories, frameworks, or concepts (in this respect, see e.g., Blois 2003a).

The conventional depiction of the business world is that of Neoclassical Economics whereby firms are portrayed as *atomistic* units, hence operating in markets (i.e., placing bids or replying to asks). Markets, naturally *faceless*, are the aggregates of the arm's-length relations established instantly and frictionlessly among buyers and sellers. In such a stylised picture of the business world, there is only room for firms and their vertical transactions (and the markets these latter overall form). However, the business world is not like that at all. It is composed of firms that are interdependent units (with interconnected behaviour and performance), necessarily developing and sustaining multiple *relations* among themselves – see below. As Allyn Young (1928) wisely advanced, the *division of labour* takes place not only *within* firms but also *among* them. That is to say, *specialisation* and '*integration*' (cooperation) go hand in hand, with the former both requiring and propelling the latter (Piore 1992). These are the two indissociable features of the division of labour, whose benefits were firstly pointed out by Adam Smith (1776 [1999]). Later on, George Richardson (1972) extended Smith's analysis by claiming that the division of labour was not only effected between firms or markets. Richardson rejected the 'distorted view' of standard theories of the firm and of markets in which the *governance* (or management) of economic activities was carried out either via *hierarchical direction* within firms or the *price mechanism* operating spontaneously among firms. He alluded to a pervasive phenomena providing an alternative *structure governance*, in addition to the *visible hand* of firms and the *invisible hand* of markets: the *interfirm cooperation*. That (vertical) cooperation, usually '*close, complex and ramified*' is clearly distinguishable from markets (and their constitutive interfirm transactions) wherein "(…) there is no continuing association, no give and take, but an isolated act of purchase and sale (…)" (Richardson 1972, p. 891).[3]

The business world is composed of multiple entities and events, not just the ones alluded to by neoclassical economists. Besides the usually mentioned *firms* and the *markets* in which they operate, the (horizontal and vertical) interfirm cooperative relations – i.e., the *inter-organisational relationships* and *business relationships* and the *networks* that the latter make

[3] Our dichotomous view of the vertical interfirm linkages including either arm's-length relations or business relationships, i.e., either transactions or interactions, can be deemed by some scholars and researchers as overly simplifying. One challenging perspective is that of Macneil (1980) who postulates a continuum ranging from discrete to relational exchanges, arguing in favour of the likely absence of purely discrete transactions between firms and that the majority of exchanges fall within that continuum. That Macneil's relational contract theory can be of great help in the conceptualisation of the business world is attested by, e.g., Dwyer et al. (1987) and Blois (2002).

up – are also prominent entities of the business world. And in addition to the oft-noted exchange relations of firms (i.e., their *arm's-length relations*), one is bound to find the *relationship significance* as a pervasive event of the business world.[4] We address briefly in turn these entities and events of the business world, giving particular emphasis to both firms and their business relationships (and their structure and powers) while ruling the inter-organisational relationships out of our main discussion.[5]

3.1 Firms

Firms are largely material entities exhibiting complex structures and therefore powers and liabilities. Firms include a myriad of *resources* and *competences*,[6] for the most part internally owned and controlled, but also externally accessed and exploited (Loasby 1998; Penrose 1959). Plus, several degrees of authority and empowerment, hierarchical levels, communication channels, rites, explicit rules, tacit conventions, and so forth can be found within firms. Owing to such complexly interrelated constituents (especially the resources and competences, both internal and external), firms are potentially endowed with certain powers and liabilities, e.g., being able to perform *activities* and generate goods, services, cash-flows, or profits.

Firms are surely interconnected entities, establishing, developing, sustaining, and terminating several types and forms of *relations* with one another (Young and Wilkinson 1997). Interestingly, *almost* all of the interfirm relations are themselves entities, mostly immaterial ones. Interfirm relations can be classified for one as *horizontal* or *vertical*. Horizontal interfirm relations display *competition* and *cooperation* facets, whereas vertical interfirm relations include *exchange* and *cooperation*. Competition is the basic feature of horizontal

[4] The *arm's-length relation* (*purely transactional relation* or *interfirm transaction*) is a basic constituent of the *market* like the *business relationship* (*interfirm interaction*) is of the *network*. Whereas the firms and their business relationships and networks, and markets are all entities of the business world, the interfirm arm's-length relations are mere events.

[5] The horizontal cooperative relationships that firms sometimes develop, mostly with their direct competitors but also with '*complementors*' (i.e., producers of complementary products) and third parties (e.g., universities, technological centres, or trade associations) are (i) usually established for specific, clearly delimited purposes, (ii) formal (i.e., ruled by written, detailed, and legally enforcing contracts), and (iii) rather short-termed (Gulati 1998). Inter-organisational relationships can take a variety of forms, e.g., alliances, consortia, interlocking directorates, joint ventures, strategic networks, and trade associations (Barringer and Harrison 2000). Despite their heterogeneity, such short-lived entities of the business world are likely to have some powers and liabilities (e.g., the ability to develop new products and the possibility of free-riding by the partner, respectively) on account of their structural features. This kind of interfirm cooperation, horizontal and formal, is less predominant in the business world than the informal and vertical one (Hakansson and Johanson 1988). For an overview of the literature on inter-organisational relationships, see the Organization Science 9(3), 1998 and the Strategic Management Journal 21(3), 2000. These entities as well as their structures and powers and liabilities (and the influence they may have on the structure and powers and liabilities of firms) are deliberately left out of our arguments here. This decision is accounted for by our primary focus being that of disclosing the causes potentially responsible for bringing about the relationship significance, an issue which (as will be seen) is not directly related to inter-organisational relationships.

[6] Firms are competent entities, exhibiting typically a limited set of *direct* and *indirect* competences for they know both (i) *how to do certain things* and (ii) *how to get certain things done by others*, respectively (Loasby 1998; Nelson and Winter 1982). Each and every competence of firms is underpinned by tacit knowledge (i.e., know-how) possessed individually or collectively by their human resources.

interfirm relations and cooperation is often found in vertical ones. But that needs not be the case, and horizontal cooperation and vertical exchange also prevail in the business world. These fourfold interfirm relations are now described briefly. Firstly, firms often compete with one another for the 'business' with (common) suppliers and customers, primarily for the acquisition of inputs and the sale of outputs. Secondly, even competitors are likely to cooperate at times, commonly through formalised and short-lived relations aiming at certain, declared purposes (e.g., new product development). Thirdly, firms engage in purely transactional relations with their suppliers and customers, buying inputs and selling outputs only at arm's-length distance. Fourthly, firms are often committed to lasting, informal, and complex relationships with some of their most important suppliers and customers. Interfirm relations boil down to competition, cooperation (either business relationships or inter-organisational relationships), and exchange (i.e., arm's-length relations).

Given the interrelatedness of firms (mostly vertical but also horizontal), their structures and consequential powers and liabilities are themselves connected to each other. That is to say, the structure, powers, and liabilities of each and every firm affect and are affected by, to varying extents and in different ways, the powers and liabilities of counterparts to which it is directly or indirectly connected (mostly suppliers and customers but also competitors). Furthermore, and what seems to be a pivotal argument of this paper, the structure and powers and liabilities of firms are likely to be somewhat influenced (e.g., enhanced or impaired) by the structure and powers and liabilities of the relationships that firms establish, develop, and sustain among themselves – that influence being allegedly stronger in the particular case of business relationships. Of course, the reverse is valid: the structure and powers and liabilities of firms affect to different degrees the structure and powers and liabilities of interfirm relationships.

3.2 Markets and arm's-length relations

All firms are vertically connected, upstream with suppliers and downstream with customers. Their vertical linkages however can differ sharply, ranging from almost instant exchanges undertaken across markets (the so-called *arm's-length* or *purely transactional relations*) to the lasting and complex relationships (often referred to as *business relationships*). Firms have in general the option to engage in either (instantaneous) *transactions* or (recurring) *interactions* with each of its suppliers and customers. That is, firms either: (i) effect discrete, on-off transactions governed by the price mechanism, wherein price and quantity prevail at large; or instead (ii) establish and develop a pattern of ongoing interactions wherein economic and social elements are exchanged, and mutual trust and commitment, reciprocity, and future interaction all matter. A firm's decision to *transact* with a certain counterpart implies necessarily the decision of *not to interact* with that same entity. It is thus understandable that these two vertical linkages, by featuring dissimilar contents, serve different purposes. While the arm's-length relations enable the acquisition or sale across markets of standardised resources, the business relationships allow firms to access and exploit complementary resources and competences of counterparts (e.g., a customer's reputation or a supplier's know-how in a field of expertise respectively). It is often the case that arm's-length relations precede business relationships for only after repeated (purely economic) purchases and sales, firms begin to get to know each other and decide to develop a cooperative relationship that goes far beyond the mere interfirm exchange (Easton and Araujo 1992). Yet not always do firms have the option to develop business relationships because of, e.g., the counterparts' lack of interest and commitment in the development of such relationships (Biong et al. 1997).

In essence, arm's-length relations are but fleeting (and naturally *structureless* and *powerless*) events that come about whenever at least two firms demonstrate the will to and agree in bringing to completion an exchange – a transaction that is almost instantly initiated and terminated. While it is more or less easy to point out the beginning and the end of an arm's-length relation, that task can hardly or unequivocally be done in the case of a business relationship. The view of interfirm transactional relations as potential events is commonly endorsed by economists, e.g., Marshall (1890 [1997], p. 182, emphasis added): "An exchange is an event (…) it is something that happens. A market is a setting within which exchange *may* take place (…).". Yet, those same economists are prone to neglect grossly the existence of some prominent entities of the business world, in particular the business relationships and the overall networks in which firms are deeply embedded. As we claim below, such intricate and ongoing patterns of vertical interaction (cooperation) are entities, surely not transitory events. Somewhat awkwardly, economists fail to acknowledge that the markets that interfirm transactions form as a whole are themselves entities. Nevertheless, markets are often referred to by some authors as '*institutions*' constructed, reproduced, and transformed by firms (Araujo 2007; Callon 1998; Loasby 2000). They comprise *inter alia* all the intermittent events constituting (taking place in) them, i.e., the set of transactional relations instantly linking firms. A large number of other elements which are to some extent indispensable for framing and governing the undertaking of interfirm transactions, such as physical spaces (marketplaces), legal or contractual rules, cultural conventions, and technologies, can also be included as a part of markets.

3.3 Networks and business relationships

As noted earlier, business relationships go beyond the purely economic transactions between firms. Such vertical relationships comprise multiple interaction episodes – face-to-face or via telephone, fax, or email – which involve the exchange of both economic and non-economic elements, e.g., money and products, and trust, commitment, and knowledge respectively (Hakansson 1982a). By drawing upon Ford et al. (1986, p. 390) and Hakansson and Snehota (1995, p. 25; 2000, p. 38), business relationships can be defined as '*(previous and current) patterns of interaction and interdependence between two firms, vertically connected and reciprocally committed to each other*'. Business relationships usually denote any *direct* relationships that the focal firm initiates, develops, and maintains upstream with suppliers and downstream with customers. Other vertical yet *indirect* relationships (e.g., those between the focal firm and its suppliers' suppliers or its customers' customers) are also typified as business relationships. "An indirect relationship is most simply described as the relationship between two firms which are not directly related but which is mediated by a third firm with which they both have [direct] relationships." (Easton 1992, p. 15). Understandably, indirect business relationships far outnumber direct ones. In contrast to the discreteness of interfirm transactions, business relationships are necessarily interconnected in many ways, not only directly or indirectly, but also positively or negatively (i.e., the interfirm interaction in one business relationship depends on the existence or absence of interaction in another relationship). The generalised connectedness of business relationships brings about co-produced, self-organising, and adaptive macro-structures (Easton et al. 1997; Wilkinson 2006; Wilkinson and Young 2002), the so-called (*business*) *networks* whose evolution is beyond any firm's control or intents and in which all firms seek to manage (Ford et al. 1998). Networks are formed and modified through multiplex interaction, thus being partly opaque (even to participant firms), 'centerless', and unbounded (Hakansson and Johanson 1993b).

The development of any business relationship is a time-consuming, path-dependent, and costly process (Hakansson and Snehota 2000). Business relationships are brought about over time as (i) reciprocal relationship-specific investments are made, (ii) both the 'distance' that normally exists at an early phase of interaction (of a social, cultural, technological, temporal or geographical basis) and the reluctance of firms to cooperate (partially related to the uncertainty regarding the counterpart's intentions and future behaviour) are greatly reduced; and (iii) the interdependence, mutual trust and commitment, and the expectations of future interaction all gradually increase (Ford et al. 1986). One is prone to consider that business relationships always develop towards an ideal state ('*a successful marriage*') where interfirm conflict is totally absent, as the likes of Ford (1980) and Dwyer et al. (1987) do in traditional life cycle models of relationship development. Yet there is no such thing as a totally cooperative business relationship and some relationships may fail to develop or are eventually terminated, for the most part owing to persistent barriers to interaction (e.g., mismatches between firms in terms of organisational culture or strategy, conflicting expectations or behaviours of individuals) (Cunningham 1982). Business relationships evolve gradually over time, as firms learn to 'dance' with one another, both leading and following (Wilkinson and Young 1994).

Both history and structure matter in business relationships (Ford et al. 1986). Current interfirm interaction is rooted in the past and shapes future interaction. Firms interact with an eye on the future of their relationship but always remembering previous interaction episodes. In addition, the surrounding structure of interactions (i.e., connected business relationships) impact upon the extant interaction amongst firms, either reinforcing or hindering it.

3.3.1 The structure and powers and liabilities of business relationships

Business relationships, on account of the above-mentioned development process, are likely to exhibit a peculiar and changeable nature or structure. According to Hakansson and Snehota (1995), their features are more or less easily perceptible and include (i) *continuity,* (ii) *complexity*, (iii) *symmetry,* and (iv) *informality* as well as (v) *adaptations*, (vi) '*coopetition*', (vii) *social interaction*, and (viii) *routinisation*. That is to say, business relationships: (i) are long-lasting; (ii) entail a multiplex interpersonal contact pattern between firms and can be deployed to pursue different objectives; (iii) are symmetrical in terms of firms' interest to develop and sustain them; (iv) are ruled by implicit and incomplete contracts; (v) involve large relationship-specific investments; (vi) display both cooperative and competitive facets; (vii) involve a myriad of extensive and interlinked social bonds between individuals and groups; and (viii) give rise to norms of mutual conduct and institutionalised rights and duties.

Owing at large to such an intricate structure (and to a smaller extent to their conspicuous connectedness), business relationships are likely to exhibit a sixfold set of *powers* and *liabilities* and are thus capable to produce *positive* and *negative effects* (for firms).[7] Like any other structured and powerful entity of the world, business relationships are '*causally efficacious*' entities. They have the potential to be *causal*, that is, are capable of bringing about change anywhere in the business world, including (i) themselves, (ii) other entities (e.g., connected business relationships and firms), and (iii) transitory events, notably arm's-length relations.

Business relationships are established, developed, and maintained mostly because of the rewarding *powers* they perform currently (or are expected to perform in the future) and the actual or potential *benefits* that result mostly for the firms directly involved in those relationships but also for connected counterparts. Those benefits however can only be obtained by firms at the expense of some actual or potential *sacrifices*, in part related to the *liabilities* of business relationships – though there can be the possibility of temporary free-riding for opportunistic firms, i.e., benefiting without suffering any sacrifice whatsoever. The latent, *potential* powers and liabilities of business relationships (and their respective benefits and sacrifices) can be as crucial as *actual* ones in the decision of firms to nurture and sustain their business relationships (Hakansson and Snehota 1995).

Powers and liabilities

Business relationships are bound to display six main powers, namely '*access*', '*control*', '*efficiency*', '*innovation*', '*stability*', and '*networking*'. That is, business relationships can have the power to provide firms with, respectively: (i) the access to, and exploitation of (and sometimes even the development of) counterparts' complementary resources and competences (Araujo and Easton 1996; Easton and Araujo 1993; Pfeffer and Salancik 1978; Thompson 1967; Wilkinson et al. 2005); (ii) the increase of influence over or the reduction of dependence on counterparts, or the promotion or block of relationship or network change (Kutschker 1982; Lundgren 1992; Mattsson and Johanson 1992; Mouzas and Naude 2007; Wilkinson and Young 2005); (iii) a reduction of the production or transaction costs (Hakansson 1982b; Hakansson and Snehota 1995; Mouzas 2006); (iv) the identification of

[7] In general, the markets-as-networks theorists refer to the powers and liabilities of business relationships and the effects resulting from exercising those powers and liabilities as *functions* and *dysfunctions* (or *non-functions*), and *benefits* and *sacrifices* respectively (Hakansson and Johanson 1993a; Walter et al. 2003; Walter and Ritter 2003; Walter et al. 2001). We stick here to the realist terminology of powers and liabilities, though take advantage of the 'benefits-sacrifices' dichotomy to address the resulting effects.

previously unknown characteristics of resources and competences, discovery of new ways of employing or new uses for extant resources and competences, or the lone or co-development of new resources and competences (Araujo et al. 1999; Hakansson 1989, 1987; Hakansson and Waluszewski 2007); (v) learning and the reduction of environmental uncertainty (Hakansson et al. 1999; Hakansson and Johanson 2001; Mouzas et al. 2008); and (vi) the management of interdependences at the actor, resource, and activity levels (Gadde et al. 2003; Hakansson and Ford 2002; Hakansson and Snehota 1989; Moller and Halinen 1999; Ritter 1999).

Business relationships are likely to display likewise six liabilities: those of failure in '*access*', '*control*', '*efficiency*', '*innovation*', '*stability*', and '*networking*'. Such liabilities follow whenever some powers are left unexercised – powers which are either expected or desired by firms to be put to work, at a given point in time, in a business relationship or in other, connected relationships. For instance, the focal firm's business relationship with customer A does not activate the expected power '*access*' or hinders the '*control*' power in the focal firm's relationship with supplier C.

<u>Benefits and sacrifices</u>

Relationship benefits and sacrifices need to be recognised as two sides of the same coin. The former are not obtained automatically, easily or for free, being partly dependent on the latter's existence (Gadde and Snehota 2000). Much time and sacrifices (at the very least costs) are needed before relationship benefits can be harvested by firms (Araujo et al. 1999). Relationship benefits include all the positive effects ensuing to firms from the activation of any of the referred powers, e.g., the access to and exploitation of external resources and competences (Anderson et al. 1994b). Relationship sacrifices encompass both (i) the *costs* incurred by firms (which are indispensable to obtain benefits) and (ii) the *deleterious effects* that sometimes result from being involved in business relationships. Three relationship costs are usually borne by all firms (Blois 1999; Gadde and Snehota 2000): (i) *opportunity costs* (e.g., the focal firm's relationship with customer A may preclude the obtainment of benefits in the business relationship with customer B or hinder the attainment of greater benefits or lower sacrifices in the relationship with supplier C); (ii) *relationship handling costs* (i.e., the costs of establishing, developing, maintaining, and terminating each business relationship); and (iii) *network handling costs* (i.e., overhead costs incurred with all or most of business relationships). Deleterious effects include: (i) *lock-in effects* (e.g., the focal firm's established business relationships may preclude the development of other, potential relationships) (Araujo and Harrison 2002); (ii) *the opportunistic behaviour of counterparts* (e.g., free-riding and hold-up problems) (Biong et al. 1997); and (iii) several other harmful consequences (e.g., the damaging effects of the focal firm's business relationship with supplier A on the former's reputation) (Anderson et al. 1994a; Mattsson 1989).

<u>The connectedness and potentiality of powers, liabilities, benefits and sacrifices</u>

Not all business relationships necessarily exhibit all the above-mentioned sixfold powers and liabilities. Each business relationship may be endowed with and put into practice different powers and liabilities over time. Of course, similar powers and liabilities (bringing about similar benefits and sacrifices) can be exercised in different business relationships. Also, at a given point in time, some powers and liabilities of one business relationship may be at work simultaneously, whilst others may remain dormant owing to the exercise of countervailing (more or equally powerful) powers and liabilities in other, connected relationships.

Inasmuch as business relationships are connected to one another in multiple ways (directly or indirectly, positively or negatively), their structures and powers and liabilities, and the benefits and sacrifices resulting from exercising these, are also likely to be themselves complexly interrelated to varying extents. For instance: (i) the exercise of the '*access*' power in the focal firm's business relationship with supplier A (and the resulting effect) may – *directly and positively* – affect and be affected by the exercise of both the '*access*' and '*innovation*' powers in the focal firm's relationships with supplier B and customer C respectively (and the resulting effects); and (ii) the incapacity or failure to put to work the '*control*' power in the focal firm's business relationship with customer D (and the non-resulting effect) may – *indirectly* – affect the incapacity or failure to put to work the '*stability*' power in the focal firm's relationship with supplier E (and the non-resulting effect). The connectedness of business relationships has two important implications with regard to their powers and liabilities and consequently the ensuing benefits and sacrifices: (i) the obtainment of benefits and sacrifices in a business relationship can be dependent not only on the exercise of the respective powers and liabilities in that relationship but more importantly require the exercise of powers and liabilities in other, connected relationships; and (ii) the obtainment of benefits and sacrifices in a business relationship can impede or impair the exercise of powers and liabilities in connected relationships and therefore impede or impair the obtainment of other benefits and sacrifices.

Simply put, business relationships are heterogeneous entities facing diverse contingencies, that is to say, their powers and liabilities are put to work under (and their structure is potentially altered by) a myriad of different and varying surrounding conditions, namely connected business relationships. As a consequence, the powers and liabilities of business relationships do not necessarily generate the events that in general are brought about whenever they are put to work. When a certain power of a business relationship is exercised at some point, there is the possibility that its 'usual' effects are not brought to be (i.e., its 'tendency' remains unfulfilled) on account of other, counteracting powers being at work simultaneously often in connected relationships. That the benefits and sacrifices of business relationships are often mediate (i.e., obtained in the future), interconnected, and partly intangible (Gadde and Snehota 2000), helps to explain why they can neither be identified by firms unequivocally *ex ante* nor are easily prone to quantification *ex post*.[8]

3.5 Relationship significance

As contended above, in opposition to a common view within the Markets-as-Networks Theory, the relationship significance should not be taken as a given. We challenge here the presumption of the relationship significance and claim instead that relationship significance is a business world event and, as such, it is only potential and brought about whenever certain causes are at work. Those causes are the focus of the next section.

4. HOW IS THE RELATIONSHIP SIGNIFICANCE BROUGHT ABOUT?

4.1 The relationship benefits and sacrifices ensuing for the focal firm as a potential cause

It seems undeniable that the relationship significance is commonly taken to be self-evident (see, e.g., Ford and Hakansson 2006a; Ford and Hakansson 2006b), or at the very least its

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[8] Of course, the focal firm can safeguard itself against likely changes in surrounding contingencies – what can be referred to as '*showery weather*' – by drafting umbrella agreements that "(…) transform implicit norms which are embedded in customs and commercial practices into explicit, basic norms for interaction", "(…) providing flexible guidance for future contractual decisions (…)" (Mouzas and Ford 2006, pp. 1249, 1250). Such written agreements feature "(…) *re-negotiation* [clauses dealing with sensitive issues, e.g., of exclusivity, confidentiality, or warranty] and the inclusion of *extreme contextual contingencies* in the form of *force majeure* (…)" and thus "(…) regulate continuing interaction between actors and translate the consequences of fulfilling or breaching exchange promises" (op. cit., pp. 1250, 1251, emphasis added).

causes are left enshrouded or not made explicit within the Markets-as-Networks Theory. We ought to recognise however that in case of hypothetical attempts made by the markets-as-networks theorists to justify the relationship significance, these are likely to allude to the overall benefits and sacrifices resulting from the exercise of the powers and liabilities of business relationships. The markets-as-networks theorists (e.g., Gadde and Snehota 2000; Hakansson and Snehota 1995) are in general prone to claim that the relationship significance is brought about by either or both of two causes: (i) the relationship benefits *outweigh* the related sacrifices, i.e., *relationship value* is co-created and partly appropriated by the focal firm;[9] or (ii) the relationship benefits are *greater* or the relationship sacrifices are *lower than* the benefits and sacrifices (a) *expected* by the focal firm (when its past experience with similar business relationships is taken into account) or (b) *potentially stemming from alternatives* to the business relationship in question, i.e., in substitute business relationships or conventional governance structures such as hierarchies and markets.[10]

We agree with the (mostly implicit) claim that the relationship derived flows of benefits and sacrifices, either *per se* or *comparatively*, are a potential cause bringing about the relationship significance. Yet this does not exhaust all the causes that can account for that notorious event of the business world. In our viewpoint, at least one *other* cause (that remains buried, somewhat underlying the identified cause) can also produce the relationship significance, in particular the strong *influence* that business relationships may have *on* a large part of the *structure* and *powers* and *liabilities* of the focal firm or, in other words, its *core nature* (resources and competences) and *scope* (activities).[11] The failure to acknowledge this cause by the Markets-as-Networks Theory may result from its *spatial boundaries*, for the main units

[9] Relationship benefits are usually weighted against the sacrifices (mostly costs) needed to attain them. And very often, the former relationship outcomes exceed the latter, that is, relationship value results for firms. Relationship value can be defined as the positive, mostly perceived, trade-off between all the benefits and sacrifices ensuing from the involvement in a business relationship, whatever those might be (Anderson 1995; Wilson and Jantrania 1994). The subjectivity of relationship value is justified with the incommensurability of both relationship benefits and sacrifices (Blois 2004, 1999, 2003b). How is the relationship value co-produced and afterward distributed as well as how it can be assessed or measured by firms, remain objects of heated dissension within the Markets-as-Networks Theory and no deliberate attempt is made here to shed light on those matters. On the notion of relationship value, see for instance the *Industrial Marketing Management*, 30(4), 2001.

[10] In addition to (or sometimes, instead of) the effects resulting from the exercise of relationship powers and liabilities being estimated and compared to each other, the focal firm can contrast them with: (i) the expected effects, by bearing in mind the benefits and sacrifices brought about in similar business relationships in the past or potentially generated in next-best substitute relationships, referred to as the '*comparison level*' and the '*comparison level for alternatives*', i.e., CL and CL_{alt} respectively (Anderson et al. 1994b; Thibaut and Kelley 1959); and (ii) the benefits and sacrifices likely to emerge in alternative governance structures, that is, if the focal firm decides to vertically integrate, or engage in arm's-length relations with counterparts respectively (Zajac and Olsen 1993). The benefits and sacrifices potentially obtainable in alternative governance structures are exhaustively detailed elsewhere, e.g., in the Property Rights Approach (Grossman and Hart 1986; Hart and Moore 1990) and Transaction Cost Economics (Coase 1937; Williamson 1985, 1981) respectively. To our best knowledge, such benefits and sacrifices have only been explicitly contrasted by Phelan and Lewin (2000).

[11] Management scholars and researchers usually refer to the structure and powers of firms *grosso modo* as their nature and scope respectively, given that the distinguishing constituents of firms are resources and competences (explaining largely their heterogeneity) and on account of those constituents, activities are performed. The (core) nature and scope of the focal firm are here equated with its resources and competences, and activities respectively – with the former being the inputs indispensable to the performance of the latter.

of analysis therein are the '*interaction*', the '*relationship*', or the '*network*' (Easton and Hakansson 1996).

4.2 The influence of business relationships on the focal firm's nature and scope: other, largely uncovered, potential cause

We have noted above that the powers and liabilities of business relationships are sixfold, to wit the 'access', 'control', 'efficiency', 'innovation', 'stability', and 'networking'. Although we do not wish to advance a hierarchy of these powers and liabilities, it seems clear that two of them ('access' and 'innovation') are more consequential than others in affecting the nature and scope of the focal firm. If it needs to be recalled, the 'access' and the 'innovation' powers (and liabilities) of business relationships supply the focal firm with (or impede it to obtain), respectively: (i) *the access to and exploitation (and on occasion the development) of external, often complementary resources and competences* and (ii) *the identification of formerly unrecognised features of or the discovery of new ways of deploying or novel uses for the extant resources and competences, or the stand-alone or co-development of new resources and competences*. The exercise of these two powers, and more importantly the effects resulting, shape to a considerable extent the resources and competences, and activities of the focal firm (both internal and external, actual and potential), that is to say, the inputs to and the '*things*' that the focal firm *does* and *gets done by others* at present and in the future.

4.2.1 Unfolding the 'access' and 'innovation' powers and liabilities: business relationships' impact upon (the inputs to and) the things that the focal firm does and gets done

<u>The focal firm does some things by itself</u>

The focal firm is a complexly structured, powerful, and interrelated entity of the business world. In a similar but mundane vein, we can depict the focal firm as a *specialised system* of resources and competences, confronting faceless *markets* and deeply embedded in intricate *networks* wherein external resources and competences are available for *acquisition* or *sale* and *access* and *exploitation*, respectively. The focal firm has necessarily a *limited* set of internal resources and competences, thus '*knowing how to do only a limited number of things*' (Patel and Pavitt 1997). The common decision of the focal firm to *specialise* in certain *things* (i.e., be *competent* only at some *activities* within a given *field of expertise*) for which it has some sort of '*comparative advantage*' (Richardson 1972), and therefore its likely appropriation of specialisation gains (e.g., in the form of experience curve effects), implies that it deliberately relies on the specialisms of others (Young 1928). Since in general the focal firm knows how to do only a few things, it surely needs to '*know how to get some things done by others*' (Loasby 1998; Nelson and Winter 1982) – notably those to which the focal firm is or will be vertically connected in some way, i.e., its current and prospective suppliers and customers. The focal firm's *specialisation* thus requires and propels its '*integration*' (Piore 1992), for the most part via *cooperation* but on occasion via *exchange* with counterparts.

<u>The focal firm gets things done by others, both via business relationships and through arm's-length relations</u>

That the focal firm owns and controls but a limited set of resources and competences within its boundaries, explains at large its proneness to (mostly vertical) cooperation, i.e., establish, develop, and sustain business relationships with suppliers and customers. The focal firm also has the possibility of getting some things done through exchange, i.e., by engaging in arm's-length relations with those same counterparts. Though the focal firm can get things done in either or both of ways, the business relationships and the arm's-length relations fulfil different roles. The *access to and exploitation (and development) of external resources and competences* in *networks* is only accomplished in the former. The latter offers a very different route, namely the *internalisation of external resources and competences (as embodied in final products)* across *markets*. The highly complementary core competences of others (suppliers and customers especially) – what the focal firm commonly aspires to – can only be accessed and exploited via business relationships. The alternative of arm's-length relations can only provide the focal firm with the outputs generated by counterparts via deploying their own resources and competences. We need of course to recognise that final products (i.e., resources or the external competences somehow embodied in those outputs) may be all that the focal firm wants on occasion, e.g., high-quality printers or premium software applications. As noted above (section 3.2), that the focal firm engages in arm's-length relations with suppliers and customers is generally because it is *unable* or *decides not to* access and exploit the resources and competences of those counterparts through business relationships (probably more costly to develop and maintain but potentially more beneficial). Moreover, the business relationships presently nurtured and sustained with suppliers and customers have often been preceded by the focal firm's engagement in arm's-length relations with them in the past. In sum, the focal firm gets *different kinds* of things done via cooperation and/or via exchange with its counterparts – and it is likely that the focal firm needs to diverse extents both of these kinds of things over time.

For sure, the focal firm gets things done at present and in the future because of its participation in business relationships (*current* and *upcoming*) and, to a probably smaller extent, its engagement in arm's-length relations (*current* and *upcoming*). The things that the focal firm gets done by others, in particular *the external resources and competences* that are *subject to* its *access and exploitation*, are inextricably tied to the business relationships it is *able* and *chooses to* initiate, develop, and sustain with several counterparts. More interestingly, the things that the focal firm does (owing to the combined deployment of its internal resources and competences) are in part bound to be a more or less direct reflection to the business relationships (and to a smaller extent, the arm's-length relations) it is *unable* or, if capable, *decides not to* engage in (Araujo et al. 1999). This seems to indicate an often neglected issue, that the things that the focal firm does by itself and the things that it gets done by others are likely to be interrelated to some extent. For the focal firm does the things that (i) it is of course capable of doing (i.e., performs the activities for which it has the necessary resources and competences) and on occasion (ii) it is unable to get done elsewhere (and unable to persuade others to do timely or adequately). However, there are always some things that the focal firm is in need of and can find externally to its boundaries. In such cases, the focal firm chooses often to get those things done via business relationships or arm's-length relations. Assume, for instance, that (i) the focal firm demands a particular set of resources and competences that are dissimilar and closely complementary to those it owns and controls internally and (ii) this set of resources and competences is externally available, i.e., housed within the boundaries of counterparts. Why should the focal firm internalise those resources and competences or instead develop them internally from scratch? There seems to be no advantage for those resources and competences being brought within the focal firm's boundaries – or in other words, the benefits and sacrifices of employing the *hierarchical* or *market* governance structures are respectively lower than and greater than the ones attained in the *relational* governance structure. The costliness of 'acquisition' across markets or of internal development needs to be taken into consideration by the focal firm (Barney 1999) and in many cases it exceeds the costs of the 'access and exploitation' via business relationships.

The influence of business relationships on the evolution of the vertical boundaries of the focal firm: the 'make-or-buy-or-access' decisions

The *dual influence* of business relationships on (the *inputs to* and most importantly) *the things that the focal firm does* and *those that it gets done* is naturally implicated in the *exercise of*, and the *effects resulting from*, the '*access*' and '*innovation*' powers and liabilities alluded to in the beginning of this section. In this regard, the business relationships can contribute to (or impede): (i) *the access to and exploitation (and on occasion the development) of the external, typically complementary competences and resources needed by the focal firm*; and (ii) *the creation of new, and the modification of the internal resources and competences of the focal firm (i.e., their enhancement or impairment)*, respectively.

Business relationships seem to have an outstanding impact over where the (changeable and blurred) *vertical boundaries* of the focal firm are to be drawn.[12] Such an impact has been corroborated by the theoretical and empirical research conducted by the markets-as-networks theorists (Araujo et al. 2003; Mota and de Castro 2004, 2005) and other scholars and researchers (e.g., Barney 1999; Langlois and Robertson 1995). By keeping that impact in mind, the '*make-or-buy*' decisions of the focal firm (about which resources and competences, and activities reside or are brought within boundaries and which ones remain outside boundaries) are somewhat transformed. The delimitation of the vertical boundaries of the focal firm cannot be reduced to a series of discrete make-or-buy decisions. Contrary to what is traditionally assumed (Williamson 1975), those decisions are not *static*, *independent*, and *dichotomous*. The make-or-buy decisions of the focal firm (i) are closely and dynamically connected to each other over time (e.g., the decision to '*make X*' may imply the decision of not to '*buy Y*' later on) and, more importantly, (ii) incorporate a third option, the '*access*' (Gibbons 2001a, 2001b). Arguably, the focal firm is not always obliged to either *develop* or *internalise* all the external resources and competences it needs – to do the things it does or aims to do – since there is usually the possibility of continuity in *accessing and exploiting*

[12] Vertical boundaries circumscribe the internal resources and competences, and activities of the focal firm, therefore demarcating the things that it does from the things that it gets done by suppliers and customers. So we can say that the focal firm's vertical boundaries (i) delimit its nature and thus (ii) define at large its scope. These boundaries are prone to display two features: (i) changeability and (i) fuzziness (Araujo et al. 1999; Hakansson and Snehota 1989). First, vertical boundaries are changeable, being subject to expansion or contraction over time (e.g., in accord with the several make-or-buy-or-access decisions taken by the focal firm). Secondly, such boundaries are fuzzy owing to (i) the continued existence of business relationships and (ii) the significance of external resources and competences for the focal firm. Given the extent of interfirm cooperation, it is difficult to trace at least unequivocally '*where the focal firm ends*' and '*where its suppliers and customers begin*'. And it is meaningless to draw them just by bearing in mind the '*ownership and control*' criteria, as if only internal resources and competences, and activities are included within the focal firm's boundaries. The vertical boundaries not only separate the focal firm from its suppliers and customers but also bring them together – they display *buffer* as well as *bridge* functions (Araujo et al. 2003; Thompson 1967).

those resources and competences (whenever they exist beyond its boundaries) via business relationships with suppliers and customers. The boundary decisions of the focal firm are hence about '*making-or-buying-or-accessing*', that is to say, (i) *internally developing* the resources and competences, and activities, (ii) *acquiring* resources and competences, and activities (via the engagement in arm's-length relations with counterparts or vertically integrating them as a whole), or (iii) *accessing and exploiting* external resources and competences (via the development of business relationships with counterparts) respectively. It is noteworthy to recognise that there is an alternative to the '*make*' or '*buy*' conventional options, namely the *access to* and *exploitation of* external resources and competences (through business relationships), and it allows the possibility to extend (or diminish) the nature and scope of the focal firm while leaving *unaltered* its vertical boundaries. Though opting for 'make' or 'buy' or 'access' is necessarily conducive to the enlargement of the nature and scope of the focal firm, 'making' or 'buying' effect the expansion of the focal firm's vertical boundaries while 'accessing' leaves those boundaries unaltered. The nature and scope of the focal firm are not defined once and for all by its vertical boundaries (given that the former two can be enlarged or reduced while the latter remain the same, e.g., via developing or terminating business relationships) but reflect largely the outcome of its multiple '*make-or-buy-or-access*' decisions taken over time.

In sum, we claim that a great part of the structure and powers and liabilities of the focal firm is likely to be influenced to a great extent by the structure and powers and liabilities of its business relationships. In other words, the primary components that constitute the focal firm and the things that it does by itself and gets done by others (i.e., its resources and competences, and activities respectively) are all strongly impacted upon the business relationships that it establishes, nurtures, and maintains with varied suppliers and customers over time. The conspicuous yet largely unarticulated *influence of business relationships on the nature and scope of the focal firm over time* is in itself *another potential cause* of the *relationship significance* – in addition to the above-mentioned cause that emphasises the powers and liabilities of business relationships and the respective effects resulting for the focal firm.

5. CONCLUDING REMARKS

This conceptual paper builds explicitly upon a critical realist meta-theory, therefore acknowledging the largely mind-independence and openness of the world, composed of a myriad of entities (with their own structures and powers and liabilities, all of them somehow interconnected) and events (likely to be brought about whenever powers and liabilities are put to work, inevitably under varying contingencies). Its main purpose has been to perform an exploration into the causes of the relationship significance, that significance being to our view a pervasive and yet insufficiently inquired event of the business world.

5.1 Theoretical contributions

The entities and events of the business world

We have provided here a realist-inspired view of the business world, for sure a part of the social world we inhabit. Arguably, the business world includes a multiplicity of entities and events. Firms are at the forefront of those entities but they are certainly not alone. Firms are complexly structured and powerful entities, probably the most prominent of the entities existing in the business world for they are responsible for bringing into existence other entities (e.g., inter-organisational relationships, business relationships, networks, and markets) and some events (notably arm's-length relations). Firms comprise a diversity of components, the most important of these being, in our perspective at least, their resources and competences. Owing to such intricate structures, firms are endowed with several powers and liabilities and thus capable of performing activities, and producing outputs, cash flows, or profits. Given their limitedness of resources and competences, firms are prone to embark on different kinds of relations among themselves, mostly via cooperation but also exchange. Vertical cooperation is more prevalent than horizontal cooperation, that is, business relationships are more frequently developed than inter-organisational relationships. Business relationships are entities on their own, exhibiting an intricate structure (e.g., long-lasting, ruled by informal contracts, entailing multiplex interpersonal contacts, and so forth) and a sixfold set of powers and liabilities (i.e., 'access', 'control', 'efficiency', 'innovation', 'stability', and 'networking'). Networks are entangled webs of connected business relationships and firms. Interfirm punctual exchanges are also commonly found to diverse extents in the business world. Such relations at arm's-length distance are mere on-off events of the business world, ruled by the price mechanism. Paradoxically, these fleeting events constitute, together with other elements which frame and govern them (e.g., technologies, marketplaces, contractual rules), the peculiar entities known as markets. The interrelatedness of firms implies that their structures and powers and liabilities are necessarily connected to one another. Surely, the powers and liabilities of firms are exercised under particular contingencies, especially the surrounding business relationships and networks.

The potential causes of the relationship significance

The relationship significance denotes the influence that business relationships have on the survival and growth of the focal firm (Kalwani and Narayandas 1995). Of course, the relationship significance can also exist *in relation to* other entities, e.g., the focal firm's counterpart or even other firms, directly or indirectly connected to each or both of them. That the relationship significance necessarily exists in relation to an entity does not mean that its existence is dependent in some way on any (right or wrong) perceptions or knowledge held by that entity. The relationship significance exists even when the focal firm is totally unaware of it.

The relationship significance is claimed to be a basic conceptual cornerstone of the Markets-as-Networks Theory. In general the markets-as-networks theorists consider it almost as an axiom, seemingly taking in uncritical fashion the relationship significance to be a corollary of the ubiquitous existence of business relationships, e.g., Hakansson and Snehota (1995, pp. 379-81). We challenge here such foundationalist position for the mere existence of business relationships does not mandate automatically their significance for the focal firm. Despite the business relationships being potentially significant for the focal firm, *not all* of them are so. Significance is certainly not a given attribute of each and every business relationship of the focal firm. The relationship significance is not a *regularity* of the business world; instead it is a *potential event* that is brought about by certain causes and, as just stressed, endures regardless of any entity's perception or knowledge of it (even that of the focal firm). Yet the relationship significance is more properly approached as varying (along a *continuum*) than a *dichotomy*, since one is able to find in the business world a diversity of business relationships, ranging from *absolutely insignificant* through *lowly significant* and *averagely significant* to *highly significant* ones.

Our main claims here are that the relationship significance is brought about by either or both of two causes: (i) the overall powers and liabilities of business relationships are put to work, under the mediation of connected business relationships, and more positive than negative effects (i.e., benefits in excess of sacrifices or relationship value) result for the focal firm or, alternatively, those benefits and sacrifices are respectively greater and lower than the benefits and sacrifices expected by the focal firm or eventually resulting from alternatives (i.e., substitute business relationships and/or alternative governance structures such as hierarchies and markets); and (ii) the exercise of the 'access' and 'innovation' powers and liabilities of business relationships (and the ensuing effects) impacts upon a great part of the structure and powers and liabilities of the focal firm, that is to say, the internal and external resources and competences at its disposal (nature) and the activities it performs (scope). The latter of these causes demands particular attention for it is in line with the common view that business relationships are privileged means by which the powers and liabilities of counterparts are made available to the focal firm for 'access and exploitation'. The participation in business relationships (and the effects resulting from the exercise of their powers and liabilities, in particular 'access' and 'innovation' ones) can help the focal firm to alter (i) its own structure (e.g., modify extant resources, exploit new external competences) and as a result (ii) its powers and liabilities (e.g., increased efficiency in the performance of activities).

5.2 Managerial implications

Our contribution is chiefly of a conceptual kind. The indisputability of the relationship significance is called into question and a causal account of its potential causes is provided. The main objectives of this work are therefore description and explanation, not prediction. We intend to answer a major research question: '*why are business relationships significant (to some extent) for the focal firm*?' or, in other words, '*how is the relationship significance brought about?*'. For sure, we do not provide definitive answers to questions such as '*Which business relationships are in general significant for the focal firm? And to what extent?*' or '*Is the business relationship with counterpart X highly significant for the focal firm at present? When is that degree of relationship significance likely to change?*'. Since the causes of the relationship significance are tentatively advanced here, it is likely that only tentative answers to these questions can be given. The fallible knowledge of the causes of the relationship significance can nonetheless give us the ability to (i) offer *tendential predictions* about the future occurrence of the event (e.g., is it likely that the relationship significance is ever brought about in the focal firm's relationship with supplier A?) or (ii) issue normative guidelines if those are needed or can be issued (e.g., what needs to change in order that the actual degree of relationship significance in the relationship with customer B is increased?). That our main contributions here are theoretical does not imply that managerial implications are entirely absent. This paper attempts to contribute directly to a more robust knowledge about, and indirectly to a more effective and efficient management of the business relationships and networks in which the focal firm is deeply embedded.

Given that (i) business relationships differ between themselves (and over time) in their relative degree of significance and (ii) the focal firm is endowed with limited resources and competences (and consequently, can be highly involved with only a limited number of counterparts), "(…) there is a need for giving certain [business] relationships priority over others" (Ford et al. 1998). The focal firm is thus advised to be rather selective in the development and maintenance of its business relationships. Different priorities should be attributed to, and attained in, differently significant business relationships. This means that the focal firm needs to effect a differentiated *relationship posture* (i.e., *degree of involvement*) in its business relationships (Hakansson and Snehota 1995, p. 131). The best way for the focal firm to '*make the most'* of its diverse business relationships is to establish and nurture both low- and high-involvement relationships, committing to such relationships lesser and greater amounts of resources and competences respectively (Gadde and Snehota 2000). The focal firm is in general strongly committed to the business relationships which are (or can become) highly significant. A low-involvement posture, on the contrary, is likely to be adopted by the focal firm in its business relationships that are low in significance. The message is clear: business relationships should be managed in varied ways by the focal firm, in accordance with their (present or future) degree of relationship significance. The differentiation in the relationship posture, in essence the *relationship* and *network management* (Ritter et al. 2004), can be implemented only when the focal firm is able to (i) identify *which* of its business relationships are (or will be) significant and to what degree and (ii) more importantly understand *why* that is the case. Only by probing into the relationship significance and identifying tentatively its potential causes, can the focal firm acquire or improve its understanding concerning the individual and collective management of business relationships. Independently of the field of study, advances in knowledge go hand in hand with improvements in practice. "[B]y extending and improving firms' understanding and sensitivity regarding relationship and network issues, better performing firms and networks will emerge (…).”(Wilkinson and Young 2002, p. 127).

5.3 Limitations and future research

The interplay between business relationships and inter-organisational relationships

One is certain to find among the multiple entities of the business world the inter-organisational relationships that the focal firm develops and maintains for the most part with its competitors. The kind of interfirm cooperation featured in those horizontal relationships differs from that of vertical relationships, with the former presenting a structure and powers and liabilities of its own. The inter-organisational relationships are often ruled by explicit contracts, are short-lived, and aim at unambiguous objectives (e.g., the access and exploitation of the resources and competences of competitors). The horizontal and vertical cooperative relationships of the focal firm are necessarily interrelated to some extent: despite being sought for diverse motives, the inter-organisational relationships and business relationships compete inevitably for the limited resources and competences of the focal firm, in particular the resources and competences dedicated to effecting cooperation with counterparts. Firms are surely responsible for bringing about business relationships as well as inter-organisational relationships. So, the structure and powers and liabilities of business relationships and inter-organisational relationships are heavily influenced by the structure and powers of the firms responsible for their establishment, development, and maintenance. The commitment to consolidate the structure and thus the powers of inter-organisational relationships are likely conducive to the absence of commitment to strengthen the structure and thus the powers of business relationships, on account of the limitedness of the focal firm’s resources and competences. The interaction between the structure and powers and liabilities of both inter-organisational relationships and business relationships is not here given the attention it probably deserves.

Relationship significance: a subject on need of further research

The absence of empirical research and findings is a shortcoming recurrently pointed out to conceptual papers. Though “(…) it is clear that research is likely to involve a division of labour between theorists and empirical researchers." (Ackroyd 2004, p. 158), scholars and researchers are in general expected to immerse in empirical sources and gather evidences to corroborate or refute a postulated hypothesis or theory, via the employment of case studies, surveys, or any other methodological tools. They are often not urged to devise, extend, or improve the current state of the art of knowledge by using conceptualisation. Contrary to the positivist conception of Science, a pure conceptual analysis (such as ours here) is not absolutely sterile. It can be proficuous and help to shed light on matters of interest. As Tsoukas (1989, p. 558) put it, both '*up in the clouds*' and '*down to earth*' research efforts are necessary.

This '*up in the clouds*' paper has called into question the indisputability of the relationship significance and provided a tentative account of its potential causes. One of our major thrusts is to trigger some discussion over the (usually taken-for-granted) relationship significance and that the near future contemplates both conceptual and empirical research, with each feeding back the other. First, it is desirable that other conceptual works on the subject are carried out. The present work is only a starting point and we hope that it can draw enough interest in order to be analytically reviewed, criticised, modified, or extended (e.g., by resorting to other bodies of knowledge). Second, the subject seems to be ripe for empirical investigations, for instance, concerning (i) the heterogeneous contingencies faced by the focal firm (namely the intricate networks of interactions and the faceless markets of transactions in which it is deeply embedded and operates at arm's-length distance, respectively) and (ii) how the potential causes of the relationship significance evolve, are put to work under, and interact over time with these changing contingencies. A diversity of more specific questions may guide such '*down to earth*' research endeavours: (i) '*in what ways do the prevailing contingent conditions (e.g., the relationship connectedness) impact on the significance of the focal firm's business relationship with customer A*?'; (ii) '*what are the dominant powers presently at work bringing about the significance of the business relationship with supplier B*?'; (iii) '*what enhances or impairs the exercise of the 'networking' power of the business relationship with supplier C*?'; or (iv) '*how do the 'access' and 'control' powers (of the business relationship with customer D) interact over time?*'. In a nutshell, we believe that a (critical realist) spiral-like approach to theory and evidence is as apposite here as in the Social Sciences at large (Sayer 2000). The analytical explanation of the world's causes needs to be complemented with intensive case studies of their operation under diverse contingencies, e.g., see Pawson and Tilley's (1997) realistic evaluation of public policy programmes featuring the contingent effects of crime prevention procedures such as electronic surveillance on the discouragement or impediment of criminal behaviour).

So far, the relationship significance can be adequately depicted as a '*black box*' on the grounds that its causes are left unidentified. The markets-as-networks theorists are therefore urged to 'open up' in a tentative manner that box, by describing and explaining the structure and powers and liabilities potentially responsible for bringing it about. That is what we have attempted to do here.

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